



TREASURY FINANCIAL MANUAL

TRANSMITTAL LETTER NO. 368

VOLUME II

TO: FEDERAL RESERVE BANKS AND BRANCHES

1. PURPOSE

This transmittal letter releases the revised chapter, II TFM 3-5000, Collateral Security Requirements. This revision updates procedures and, in particular, tightens the collateral sanctions and introduces a monetary penalty. It also revises the Third-Party Custody Agreement and provides two different formats of the agreement at the appendices.

PAGE CHANGES

Remove

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Part 3 (Dec 92)

II TFM 3-5000 (T/L 349)

Insert

Table of Contents to
Part 3

II TFM 3-5000

3. EFFECTIVE DATE

Upon receipt.

4. INQUIRIES

Any questions concerning this transmittal letter should be directed to:

Cash Management Policy
and Planning Division
Financial Management Service
Department of the Treasury
Liberty Center, Room 420-A
Washington, DC 20227
Telephone (202) 874-6590

Date: April 20, 1993

Russell D. Morris
Commissioner

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PART 3 - FEDERAL TAX DEPOSITS AND TREASURY TAX AND LOAN ACCOUNTS

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*Part 3 - Chapter 5000***COLLATERAL SECURITY REQUIREMENTS**

This chapter prescribes procedural requirements to be followed by Federal Reserve banks (FRBs) and branches with regard to the pledging and policing of collateral security.

Section 5010 - Authority

The regulations governing Treasury tax and loan (TT&L) depositaries and their participation in the TT&L Investment Program are prescribed in the Code of Federal Regulations at 31 CFR 203. The regulations governing Treasury's recognition of insurance covering TT&L depositaries appear at 31 CFR 226.

Section 5015 - Pledging Collateral Security

A TT&L depositary is required to pledge securities pursuant to the terms prescribed in 31 CFR 203.14. Collateral security must be pledged to secure (1) all amounts credited to the TT&L account in excess of recognized insurance coverage and (2) the total balance in the note account, if applicable.

If a depositary is insured by an organization that is not authorized by the Financial Management Service (FMS), it will be required to pledge collateral equal to the total closing balance in its TT&L account and the total amount of the note balance, if applicable. Periodically, FMS will review insurance programs that have been approved and will inform FRBs of any programs that no longer meet Treasury's requirements.

Collateral security will be pledged with the FRB of the dis-

trict, or with custodians within the United States designated by the FRB. FRBs are authorized to accept a wire advice as interim evidence of a pledge of collateral pending actual delivery of a custody receipt. The wire must be sent by the custodian rather than the pledging financial institution. Collateral pledged to secure Special Direct Investments (II TFM 3-2050.30) may, under the terms and conditions prescribed by the FRB, remain off premises in the depositary's possession (Section 5040).

In the depositary's contract with Treasury, the depositary agrees that (1) in the event of its insolvency or closure, or (2) in the event a receiver, conservator, liquidator, or other similar officer is appointed, the Secretary of the Treasury may redeem or sell the pledged collateral. The proceeds of the redemption or sale will be applied to satisfy any claim of the United States.

5015.10 - Note Option Depositary

A note option depositary is required to establish a maximum balance (II TFM 3-2040) and to fully collateralize its maximum balance at all times. The FRB will automatically withdraw any portion of an advice of credit that would cause the note balance to exceed the maximum. Special direct investments, which are secured by collateral

held under off-premises custody (OPC) arrangements will not be considered in determining the amounts to be withdrawn automatically when a depositary's maximum balance is exceeded.

If a note option depositary participates in direct investments, it must establish a maximum balance. Direct investment depositaries are encouraged, **but are not required**, to collateralize their maximum balance at all times. If a direct investment depositary does not fully collateralize its maximum balance at all times, it must pledge sufficient additional collateral **no later than the day a direct investment is placed** to cover 100 percent of its note balance at the close of business that day.

If a direct investment depositary advises the FRB it cannot pledge the necessary additional collateral, the FRB should not place the direct investment with that depositary. If the FRB places a direct investment, and the depositary fails to pledge additional collateral, the FRB will withdraw the balance in the note account exceeding the collateral pledged. The withdrawal must be effected on the morning of the first business day following the direct investment. If, in the opinion of the FRB, a direct investment depositary has a history of frequent collateral deficiencies, the FRB may require the depositary to fully collateralize its maximum balance at all times.

If a note option depositary is a credit union insured by the Administrator of the National Credit Union Administration, recognized insurance coverage (currently \$100,000) will be applied to the TT&L and note account balances in the aggregate. Any amount exceeding recognized insurance must be collateralized. Some State Sponsored Insurance Organizations (SSIOs) approved by Treasury also provide coverage for TT&L and note account balances. The FRB will be advised by Treasury which SSIOs provide insurance coverage for both account balances in the aggregate.

5015.20 - Remittance Option Depositary

Prior to crediting deposits to its TT&L account, a remittance option depositary will pledge collateral security of the classes required in Section 5025. The amount of collateral security must be sufficient to cover the balance in the TT&L account at the close of business each day, less recognized insurance coverage.

5015.30 - Release of Collateral

If the FRB has reason to believe that the release or redemption of collateral would cause a depositary to be deficient, the FRB will not approve the request until sufficient additional collateral is pledged by the depositary. The redemption of matured Treasury securities in book-entry form will be handled as stated in Section 5025.

Since the depositary pledges collateral based on the account balances on the depositary's books, the FRB will honor a request for a release of collateral if the depositary indicates the release or redemption will not cause its accounts to be undercollateralized. The FRB will monitor release

transactions through the monthly collateral policing report.

Section 5020 - Valuation of Collateral

Collateral will be accepted at the same value applied by the FRB to the same collateral when pledged by the same depositary to secure borrowings (advances) from the FRB. Most collateral will be accepted at face value or at a percentage of face value. Face value is the principal amount of the securities less payments made, if appropriate.

If the collateral pledged declines in value as payments are made on the principal, the FRB will adjust its records periodically to reflect the reduction in collateral value. The FRB will adjust its records on the basis of a certification furnished by the pledging depositary concerning the face value of collateral pledged. Except for collateral pledged for Special Direct Investments/OPC (Section 5040), the FRB will obtain certifications from depositaries as frequently as conditions warrant, but not less than semiannually.

Section 5025 - Acceptable Securities

Unless otherwise specified by the Secretary of the Treasury, pledged collateral may be transferable securities of any of the following classes [31 CFR 203.14(d)]:

a. Obligations issued or fully guaranteed by the United States or any U.S. Government agency (at 100% of face) and obligations of Government-sponsored corporations, which under specific statute may be accepted as security for public funds (at 90% of face).

b. Obligations issued or fully guaranteed by the International Bank for Reconstruction and Development, the Inter-American Development Bank, or the Asian

Development Bank (at 90% of face).

c. Obligations partially insured or guaranteed by any U.S. Government agency (at a value equal to 100% of the amount of the insurance or guarantee).

d. Notes representing loans to students in colleges or vocational schools that are insured either by Federal insurance or by a State agency or private nonprofit institution or organization administering a student loan insurance program in accordance with a formal agreement with the Secretary of Education under the provision of the Higher Education Act of 1965 or the National Vocational Student Loan Insurance Act of 1965 (at 90% of face).

e. Obligations issued by States of the United States (at 90% of face).

f. Obligations of Puerto Rico (at 90% of face).

g. Obligations of counties, cities, and other governmental authorities and instrumentalities that are not in default as to payments on principal or interest (at 80% of face).

h. Obligations of domestic corporations that may be purchased by banks as investment securities under the requirements of Federal bank regulatory agencies (at 80% of face).

i. Commercial and agricultural paper and bankers' acceptances approved by the FRB of the district (at a maximum of 90% of face).

j. Zero-coupon obligations of the U.S. Government marketed as "Treasury STRIPS" (at 90% of the value determined periodically by Treasury).

Included under subparagraph i. above are notes representing loans to commercial customers. In addition to observing all of the practices and conditions that each FRB cur-

rently observes when accepting securities as collateral under subparagraph i., the following additional criteria will be observed. The securities must be—

- Marketable, that is, not contain any provision limiting their assignability or transferability.
- Limited to obligations of domestic entities (that is corporations, partnerships, and sole proprietorships.)
- Subjected to an adequate credit analysis prior to their acceptance as collateral security for tax and loan purposes.

If the FRB performs credit analyses on certain securities in addition to those pledged under subparagraph i. prior to accepting the securities as collateral for borrowings from the FRB, the FRB also will subject these securities to a credit analysis before accepting them as TT&L collateral.

Although 31 CFR 203.14(d) specifies that securities pledged as collateral must be transferable, exceptions have been made for Promissory Notes and Treasury Certificates of Indebtedness (Eurodollar series) of the Export-Import Bank of the United States. These securities, which were offered only to foreign branches of U.S. banks, were eligible as collateral from the payee bank named on the securities. FRBs will receive specific instructions from Treasury authorizing any similar exceptions in the future.

When full payment for United States or U.S. Government agency securities is made prior to issuance, the securities may be considered as being held as collateral security as of the payment date.

Any securities issued that have had unmatured interest coupons removed are not acceptable as collateral for TT&L purposes.

A TT&L depository that pledges securities that are not negotiable without its endorsement or assignment may furnish an appropriate resolution and irrevocable power of attorney authorizing the FRB to assign the securities, instead of placing its unqualified endorsement on each security. The resolution and power of attorney will conform to all terms and conditions prescribed by the FRB.

The Treasury Department's Fiscal Agency Securities Manual, Volume II, does not permit FRBs to hold matured Treasury securities in book entry form, even if pledged as TT&L or other collateral. FRBs will credit the depositor on the due date for maturing securities pledged to TT&L. If a collateral deficiency results, the deficiency will be handled as outlined in Section 5050.

Section 5030 - Participation Arrangement Certificates

When two or more financial institutions participate in a loan that is guaranteed or insured by the United States or a U.S. Government agency, the agreement that guarantees the loan generally applies only to the lead financial institution. It does not specifically guarantee individual members of the participation arrangement by name. Therefore, participation certificates relating to such loans are acceptable for collateral purposes provided they adequately identify the loan and meet the following conditions:

- a. The certificate contains the following provision: "Participant may assign or endorse this certificate of participation to the (Name of the FRB or branch where the participant is located) in connection with a pledge of collateral security to protect a TT&L account under 31 CFR 203. In the event that this certificate of participation is assigned to (same FRB or branch

as above), it will not be further assigned or subdivided without prior written notice to that bank and the prior written consent of this financial institution."

- b. The certificate will be supported by copies of the insurance or guarantee agreement relating to the basic loan and the necessary power of attorney and resolution in favor of the FRB as prescribed in 31 CFR 203.14(e).

- c. The agreement will provide that the guarantee or insurance is transferable to any participant or beneficiary.

- d. When all members of the participation arrangement are located within the same FRB territory, the FRB may allow the lead financial institution to pledge the guaranteed or insured note in favor of the FRB. The lead financial institution must indicate in its assignment how the collateral value of the note is to be allocated between the financial institution and its participants. The participants will provide a statement pledging and assigning their share of the note.

Section 5035 - Third Party Custody Agreement

The third party custody agreement is one between an FRB, as Fiscal agent of the United States, and an institution, which holds collateral on its premises as an agent of the FRB on behalf of a depository financial institution (the pledgor). The FRB will use the "Third-Party Custody Agreement" either in operating circular (Appendix 1) or letter format (Appendix 2) when contracting with and designating third party custodians.

The agreement allows both bearer securities and securities in registered form to be placed with the third party custodian. The FRB must ensure the collateral listed on the Advice of Custody satisfies the

same eligibility standards as collateral in its custody.

To qualify for designation as a third party custodian, the financial institution must (1) be in the business of providing securities safekeeping services for other depository institutions, (2) have been in that business for at least one year and (3) be approved by an FRB.

If a custodian has been authorized by one FRB, that authorization automatically will be binding throughout the Federal Reserve System, although the agreement does provide a mechanism whereby an FRB may revoke acceptance of a custodian. The contracting FRB will immediately notify all other FRBs and FMS (see contact page for address) of any new or terminated custodial agreements. The FRB will periodically receive a listing of participating custodians from FMS.

The Third Party Custody Agreement is used only with custodians that hold collateral for a pledgor on their premises. Extended custody arrangements are permissible, however, different agreements are required for such arrangements. The fourth party in an extended custody arrangement must be a Securities Exchange Commission (SEC) registered clearing agency that has been approved by the Department of the Treasury and authorized by an FRB.

At the present time, the Depository Trust Company (DTC) is the only approved fourth party custodian. The FRB of New York has executed the "DTC/FRB of New York - Third Party Custody Agreement" on behalf of all other FRBs. However, each FRB must execute an individual pledge account agreement with DTC to formalize the extended custody relationship, if applicable.

FRBs must ascertain the location of collateral pledged under 31

CFR, Parts 202 and 203, held by depositories in their districts. All custodians holding such collateral must execute a new Third Party Custody Agreement. All custodians that hold such collateral off their premises should either execute new agreements reflecting the fourth party relationship (if they hold collateral at an FRB-approved custodian) or they must terminate their custodian relationship. No extended party custodians beyond the fourth party custodian are permitted.

Section 5040 - Collateral For Special Direct Investments (SDIs)

Title 31 of the Code of Federal Regulations, Section 203.14(d), lists the ten classes of collateral that are eligible to be pledged as collateral to secure TT&L account balances. For the purpose of OPC arrangements, only instruments included in classes 4 through 8, and FHA and VA-backed mortgages (class 3) are eligible. In addition, class 1-4 family mortgages are eligible if they are accepted by the FRB of the district to secure borrowings from the FRB under its Borrower-in-Custody procedures.

The quality standards of securities pledged under OPC arrangements will not be inferior to the quality of collateral accepted by FRBs for tax and loan purposes. The FRBs will prescribe the quality standards for each class of collateral pledged under OPC arrangements (II TFM 3-2050).

Collateral pledged under OPC arrangements will be valued at the same values applied by the FRB to the same collateral when pledged to secure borrowings from the FRBs. Where declining value securities are pledged, it will be necessary for the depository to submit to the FRB at least quarterly an updated statement reflecting the re-

vised value of the collateral pledged.

The Depository will grant security interest in the pledged collateral by delivering to the FRB an advice of custody agreement fully describing the collateral covered by the agreement. A full description of each item covered by the Security Agreement will consist of, at a minimum, the following information:

- The name of the obligors.
- The name in which the collateral is registered.
- Any CUSIP number or other account number identification.
- The face value and the current amount outstanding, if different.
- The issue date.
- The maturity date.
- The appropriate rate of interest.
- The State and County where any real property securing the collateral is held.
- The address of the depository at which the collateral is held.
- The purpose of the pledge; for example, to secure SDIs under the terms of 31 CFR 203.14 - for TT&L/SDI.

Section 5045 - Collateral Policing Procedures

FRBs are required to review the adequacy of collateral pledged by note and remittance option depositories to ensure that TT&L account balances and note account balances that are not covered by deposit insurance are fully secured by a pledge of collateral. Procedures established to monitor a depository's compliance with these collateral requirements can only be performed after the fact.

The scope of the collateral policing procedures is described as follows:

a. FRBs will generate daily and monthly collateral deficiency reports to police, on a daily and monthly basis, the adequacy of collateral pledged.

b. A distinction will be made between depositaries based on the frequency and degree of deficiencies. Depositaries with minimal deficiencies will be policed primarily using the monthly historical report. Depositaries with serious deficiencies will be policed using both daily and monthly reports.

c. FRBs will use definitive criteria to determine what size deficiency will require action. The general actions to be taken are specified in this section. However, on a case-by-case basis, the action taken may be harsher or waived at the discretion of FRB management. The procedures are intended to ensure general consistency of approach system-wide and to minimize the frequency and size of collateral deficiencies.

d. A definite structure of contacts, escalating up to Treasury officials, will be specified in cases where collateral deficiencies are recurring.

e. Sanctions will be imposed on those depositaries that undercollateralize their balances during three reporting cycles in a moving 12-month period.

f. Penalties may be assessed against certain depositaries on sanction that continue to incur collateral deficiencies.

g. The monthly report will complement the daily report and will provide the primary mechanism for identifying and correcting recurring deficiency situations. The daily report will identify serious deficiencies that require immediate attention.

5045.10 - Daily Policing Procedures

The daily policing procedures are designed to ensure that the FRB takes prompt action on "serious" deficiencies. This does not exclude depositaries with minimal deficiencies from the 100 percent collateral security requirement.

On a daily basis, the FRB will review the "Daily Collateral Policing Report" to identify serious deficiencies and contact the depositaries. Based on the FRB's books, the daily report will provide the total credits to the depositary's TT&L account that day (for note option depositaries, the balance in the note account), the amount of collateral pledged, the dollar amount of the deficiency and what percentage the deficiency is of the account balance. For a remittance option depositary, consideration will be given to recognized insurance coverage.

The FRB will take action on (1) a deficiency on the daily report of 10 percent or more of the account balance on the depositary's books and at least \$50,000, or (2) any deficiency of \$500,000 or more regardless of the \$50,000/10 percent criteria.

If a serious deficiency is identified, the FRB will remind the depositary by telephone of the collateral requirements (Section 5015). If a depositary does not agree to comply, the FRB will advise the depositary of the potential sanctions (Section 5055).

5045.20 - Monthly Policing Procedures

On a monthly basis, if an account is undercollateralized (1) at least three times by 1 percent or more of the account balance on the depositary's books and at least \$5,000 or (2) at least one time by \$500,000 or more, the FRB will take action (Section 5055).

The criteria established under monthly procedures do not detract from the requirement for 100 percent security protection. The criteria used to identify those depositaries to be contacted are internal administrative guidelines for FRB management and will not be released to depositaries during written and oral communications.

As soon as possible after the close of a reporting cycle, the FRB will compare the balance in the TT&L account on the depositary's books for each day of the reporting cycle (less recognized insurance coverage) plus the balance in the note account, if applicable, with the amount of collateral pledged that day to secure the accounts. These procedures assume that deposits remain on a remittance option depositary's books until called in by the FRB upon receipt of an advice of credit.

The FRB will generate the "Monthly Collateral Policing Report," which will provide the following information:

- The closing balance in a depositary's TT&L and note account as of the day of deposit based on the date of the advice of credit.
- The amount of recognized insurance coverage.
- The amount of collateral pledged to secure the accounts each day.
- If there is a collateral deficiency, the percentage the deficiency is of the total of the TT&L (less recognized insurance coverage) and the note account balance (if applicable) on the day of the deficiency.

Report to Treasury. The FRB should forward a copy of each monthly collateral policing report to FMS (see contact page) by the end of the month in which the reporting cycle ended. The report will be used to monitor the effec-

tiveness of the collateral policing procedures.

Section 5050 - Collateral Deficiency Sanctions

The FRB will send notices to the depositories meeting or exceeding the deficiency criteria established for the monthly report. The effect of the notices will be as follows:

a. First Notice - The first notice reports the number and amount of deficiencies, states the regulatory requirement for collateral, and advises the FRB is willing to help the depository fully secure its account balances.

b. Second Notice - The second notice reports the number and amount of deficiencies, cites the previous notice, advises sanctions will be imposed on the depository in the event of a third notice in a moving 12-month period and warns of the potential for penalties if deficiencies continue. A moving 12-month period is determined by projecting 11 months after the month of the first notice. The letter may also estimate the additional collateral needed to resolve the deficiency situation. This notice will be addressed to senior management at the depository. The letter will also stipulate the FRB's procedure for same-day transfers in instances when a depository is unable to pledge adequate collateral.

c. Third Notice - The third notice reports the number and amount of deficiencies, cites the two previous notices, specifically states the sanctions and the date the sanctions are to be imposed and warns of the potential for penalties if deficiencies continue. This notice will be addressed to senior management at the depository. The letter shall also stipulate the FRB's procedure for same-day transfers in instances when a depository is unable to pledge adequate collateral. Prior to receiving the third notice, a de-

pository will be advised by telephone in advance of its pending sanction.

It is not necessary for the FRB to issue a deficiency letter or place a depository on sanction if, during the cycle under review, the depository raised, and has maintained, its collateral at a level that would have fully collateralized its balances when the deficiencies occurred.

If a depository under sanction does not pledge the amount of collateral security required under paragraphs 5050.10 and 5050.20, the FRB should advise senior management at the depository that the case will be referred to FMS (see contact page) unless appropriate action is taken within 15 calendar days. If the depository does not take action, the FRB will refer the case to FMS with the history of all actions taken by the FRB.

At its discretion, the FRB may require a depository on sanction to electronically transmit its advices of credit to the FRB. The method and timing of the electronic transmission will be determined by the FRB.

5050.10 - Collateral Sanctions (Note Option)

Upon forwarding the "Third Notice" to a depository, the FRB will contact the depository by telephone and make preparations to impose collateral sanctions. The sanctions to be imposed will require the depository to collateralize, at a minimum, 125 percent of the average daily amount of funds-in-transit in addition to fully collateralizing the maximum balance set for its note account. The FRB may require more collateral if it is clear that 125 percent of the average amount of funds-in-transit will not be sufficient to significantly reduce deficiencies. The sanction will be imposed on the first business day of the reporting cycle following notification of sanction.

The FRB will determine the average daily funds-in-transit using the funds-in-transit report (II TFM 3-4035.35). If the depository does not pledge sufficient additional collateral, the FRB should compute and establish a lower maximum balance based on the amount of collateral the depository has currently pledged.

5050.20 - Collateral Sanctions (Remittance Option)

Upon forwarding the "Third Notice" to a depository, the FRB will contact the depository by telephone and make preparations to impose collateral sanctions.

Remittance Option depositories under sanction will be required to collateralize, at a minimum, 125 percent of the average daily amount of funds-in-transit from the most recently available funds-in-transit report. The FRB may require more collateral if it is clear that 125 percent of the average daily amount of funds-in-transit will not be sufficient to prevent deficiencies. The sanction will be imposed on the first business day of the reporting cycle following notification of sanction.

5050.30 - Duration of Sanctions

Under both options, sanctions imposed will remain in effect for six reporting cycles. At the end of the sixth cycle, the three-notice process will begin again. If a depository is placed under sanction on a recurring basis, the FRB may recommend to FMS that the sanction be made permanent. The recommendation will be forwarded to FMS with appropriate supporting documentation.

5050.40 - Deficiencies While on Sanction

If a depository on sanction continues to incur serious deficiencies

(10 percent/\$50,000 or \$500,000), and the FRB believes the deposits causing the deficiencies are anticipated or predictable, the FRB may require the depository to transfer the uncollateralized funds to the FRB on the same day the funds are received by the depository. FRBs may also request these depositories transmit mid-day advices of credit to be processed by the FRB the same day.

If a depository on sanction incurs deficiencies totaling \$500,000 or more, it will be assessed a penalty on the total amount of deficiencies it incurs. The penalty will be calculated by multiplying the total deficiencies for a cycle by the daily interest rate factor of the average weekly Federal funds rate for the cycle in which the deficiencies occurred.

The interest rate factor for each cycle will be included on the interest rate wire (II TFM 3-3015.10). A penalty of less than \$100 will be waived.

FRBs will collect penalties assessed against depositories on sanction for collateral deficiencies incurred on the second business day of the reporting cycle. **The FRB will complete an SF 215 using ALC 20180002, Account Symbol and Title 201484.1 - Interest on Deposits and Investments in TT&L Depositories - Collateral Deficiency.**

5055.50 - Report to Treasury

The FRB will report to FMS the names of the depositories under sanction. This list of depositories will be attached to the "Monthly

Statistical Report" (II TFM 3-4035.50), and for each depository it will indicate the last cycle of the sanction period.

Section 5055 - Exceptions

The procedures for collateral policing and the imposition of sanctions are specific; however, Treasury recognizes circumstances may arise where FRB discretion is warranted. The FRB may impose more or less stringent requirements on a case-by-case basis where unusual or extenuating factors affect the collateralization of balances. The FRB will document the facts and reasons for actions taken for review purposes.

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CONTACTS

For inquiries concerning this chapter, address questions to:

**Cash Management Policy
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Liberty Center, Room 420-A
Washington, DC 20227
Telephone (202) 874-6590**

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APPENDICES LISTING

App. No.	Form	Title
1		Third-Party Custody Agreement Operating Circular Format
2		Third-Party Custody Agreement Letter Format

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APPENDIX NO. 1

FEDERAL RESERVE BANK
OF []

[Appendix A to]
[Operating Circular No. ____]
[Revised effective]
[Feb., 1993]

THIRD-PARTY CUSTODY AGREEMENT

Depository Institution's offer to Contract and Application for Designation as a Third-Party Custodian of Collateral Pledged Under 31 C.F.R., Parts 202 and 203

To All Depository Institutions in (the Second Federal Reserve District):

This operating circular appendix (the "Appendix") sets forth the terms of the agreement between a depository institution (the "Custodian") and this Bank regarding the holding, as agent for the Bank and any other Federal Reserve Bank in its capacity as Fiscal Agent of the United States, of securities pledged to such Reserve Bank by any other depository institution (the "Pledgor") to secure deposits of public money under the provisions of Parts 202 and 203 of Title 31, Code of Federal Regulations. To support its application under this Appendix, the Custodian represents that it is in the business of providing securities safekeeping services for other depository institutions and has done so for at least one year. In order for a Custodian to be qualified and designated as Custodian by this Bank, the Custodian must execute and return to this Bank a letter agreement in the form specified in the Exhibit to this Appendix.

This application is for use only by Custodians that hold collateral in safekeeping on their premises. With the knowledge and prior approval of the Reserve Bank, and after executing specific agreements required by the Reserve Bank for such extended custody arrangements, Custodians may place securities in the custody of a depository which is an S.E.C.- registered clearing agency approved by the United States Department of Treasury for such purposes, for transfer to a Reserve Bank account which has been established to receive pledges of securities at such depository, subject to terms and conditions acceptable to the Reserve Bank.

Terms of Agreement

Custodian hereby applies to the Federal Reserve Bank of [] to act as a third party custodian for the Bank and any other Federal Reserve Bank (any of which are hereinafter referred to as the "Reserve Bank"). If designated as qualified to be a

Custodian by the Reserve Bank, and in consideration of the benefits and privileges related to such designation, the Custodian promises, warrants, and agrees:

1. To hold in its custody, as agent of the Reserve Bank, those eligible securities which a Pledgor may pledge as collateral to secure deposits (Federal Reserve book-entry eligible securities may not be held by a custodian.)
2. To hold the securities pledged subject exclusively to the Reserve Bank's written or properly authenticated wired instructions for release, delivery, substitution, withdrawal or other disposition. All instructions shall be executed without delay upon receipt of a written or properly authenticated wired order from the Reserve Bank to that effect. "Wired" transmissions as referred to in this document may be sent by cable, facsimile, telegraph, telephone or other electronic transmission designated by the Reserve Bank.
3. To hold all collateral in safekeeping on the Custodian's premises.
4. To support every pledge of collateral by issuing to the Reserve Bank an advice of custody, in conformance with the following:
 - a. each advice of custody issued shall be delivered to the Reserve Bank in accordance with the Reserve Bank's delivery time schedules;
 - b. each advice of custody shall be issued only after the Custodian has confirmed that it possesses the securities; i.e., that the securities are (i) present on the Custodian's premises, or (ii) in the possession of a transfer agent for the purpose of re-registering them in the name of the Custodian's nominee;

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c. each advice of custody issued shall include only securities which are negotiable or transferable. (For requirements regarding assignment of securities, see 31 C.F.R., Part 202.6(d) or 203.15(e));

d. each advice of custody issued shall specify, without limitation, the following:

- i. the name of the Pledgor;
- ii. the name of the Custodian's nominee if any, in whose name the pledged securities are registered;
- iii. a full description of the security, including the name of the issuer, CUSIP number, maturity date, and rate of interest;
- iv. the original face value of the security, and the remaining balance for declining balance securities;
- v. the name of the Reserve Bank pledgee;
- vi. the purpose of the pledge; i.e., whether the collateral is being pledged to the Treasury under 31 C.F.R., Part 202 or Part 203. Separate advices of custody should be issued for collateral pledged under each Part.

- 5. That an advice of custody regularly issued with printed, facsimile, or other non-manual signature of an authorized officer or an electronic transmission of the Custodian shall have the same effect as if issued and manually signed by an authorized officer of the Custodian, provided the Reserve Bank receiving the advice has received prior written notice, and approved of the Custodian's procedures in this respect.
- 6. That each advice of custody issued to the Reserve Bank shall be conclusive evidence of the facts stated in the advice.
- 7. That any (a) interest payments by the obligor with respect to securities pledged under this custodial arrangement, and (b) proceeds of the redemption of maturing coupons shall be paid to the Pledgor, unless otherwise directed by the Reserve Bank.

Proceeds received with respect to principal payments on declining value securities shall be paid to the Pledgor unless the Reserve Bank directs otherwise. (Declining value securities are eligible only as collateral to secure public money under 31 C.F.R. 203).

- 8. That the Custodian shall hold securities on its premises as agent for the Reserve Bank without compensation from the Reserve Bank, free and clear of all liens, charges or claims by the Custodian for safekeeping or otherwise, and shall mark its books to show that collateral is pledged to the Reserve Bank.
- 9. With respect to securities pledged under this Appendix, to indemnify and hold the Reserve Bank and the United States harmless from any loss that is proximately caused by the negligence or willful misconduct of the Custodian, or its employees, or agents, and that arises from the destruction, disappearance, theft, or unauthorized release of such securities.
- 10. With respect to those securities pledged under this Appendix that decline in value as payments of principal are made, to provide to the Reserve Bank, on not less than a quarterly basis, a statement of the original face value and the value of the remaining balance on each declining-value security pledged.
- 11. To comply with terms and conditions specified by the Reserve Bank under instructions issued to prescribe the routine mechanics of pledging collateral, except that, in the event of any inconsistency between the terms of this document and the specified terms and conditions or the terms and conditions of the Custodian's advice of custody, the terms of this offer to contract and application, shall prevail.
- 12. To permit the Reserve Bank to inspect during the Custodian's regular business hours the Custodian's safekeeping premises, books, and records of custodial accounts, and any securities pledged hereunder.
- 13. To promptly respond in writing to the Reserve Bank's periodic requests for verification of the securities in its custody that are pledged to the Reserve Bank. Such requests will list the information required in an advice of custody (as set forth in paragraph 4d of this Appendix) for all securities which the Reserve Bank's records reflect as being held by the Custodian and pledged to the Reserve Bank. The Custodian shall respond in writing by either confirming that it holds all such securities and that all information in the Reserve Bank's request is correct or by specifying any differences reflected in its records, whichever is appropriate.

Nothing in this Appendix affects the Reserve Bank's supervisory or regulatory powers, or any other rights the Reserve Bank may have with respect to the Custodian. If the United States Department of the Treasury issues any amendment of this Agreement, notice will be provided to the Custodian by the Reserve Bank 60 calendar days in advance of the date such amendment becomes effective, provided the Treasury Department notifies the Reserve Bank to give such notice prior to that time, as the Treasury Department reserves the right to make amendments effective immediately (or in fewer than 60 calendar

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days) if such notice is impractical, unnecessary, or not in the public interest. Unless otherwise provided, any amendment will apply to all pledges of securities under this Appendix made on or after the effective date of the amendment.

The Custodian may resign by giving 60 calendar days' prior written notice to both the Reserve Bank and the Pledgor. The resigning Custodian shall, on the effective date of its resignation, assign, transfer, and deliver to the Reserve Bank or the successor custodian designated to the Custodian by the Reserve Bank in writing, all funds, securities or other assets held at that time by the resigning Custodian under this Appendix without recourse, representation, or warranties of any kind, except as to acts or omissions of the resigning Custodian or claims against the resigning Custodian arising under this agreement prior to, or on the effective date of, the Custodian's resignation.

The acceptance of this Offer and the designation of the undersigned institution as Custodian may be revoked by any Reserve Bank with respect to that Reserve Bank, by providing the Custodian with advance written notice of such revocation. The revocation shall be effective ten calendar days, after the date the notice is sent or transmitted. A copy of such notice shall simultaneously be transmitted to each of the other Reserve Banks. The notice of revocation may also contain instructions or orders to the Custodian concerning the assignment, transfer, and delivery to the Reserve Bank of all funds, securities and other assets held by the Custodian under the terms of this Appendix. Revocation shall not affect the Reserve Bank's or the United States Department of Treasury's rights hereunder, with regard to any collateral pledged under the Appendix prior to revocation.

This Offer to Contract and Application for designation as a Third Party Custodian of Collateral Pledged Under 31 C.F.R., Parts 202 and 203, supersedes any prior agreements for this purpose which may currently be in effect between the Custodian and the Reserve Bank. The undersigned depository institution agrees that upon acceptance by the Federal Reserve Bank of _____ acting as Fiscal Agent of the United States, this document shall evidence the contract entered into between the Secretary of the Treasury and the Custodian.

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EXHIBIT I

LETTER AGREEMENT FOR THIRD PARTY CUSTODY OF COLLATERAL
UNDER 31 C.F.R. PARTS 202 AND 203

Federal Reserve Bank of _____
[_____ Branch]

Gentlemen:

In order to qualify and be designated by you as a third-party custodian for any Federal Reserve Bank of securities pledged to the Reserve Bank by any other depository institution (the "Pledgor") to secure deposits of public money under 31 C.F.R., Parts 202 and 203, and in consideration of the benefits and privileges related to such qualification and designation, we agree to the provisions of Appendix A to your Operating Circular No. _____ as revised from time to time. Enclosed is a list of Pledgors that have requested that we act as their custodian for this purpose. We will provide you with a current list of Pledgors for whom we act as Custodian as changes, from time to time, are made.

This letter is signed on our behalf by an officer duly authorized to execute such a document, as is evidenced by the certificate executed below.

[Name of Depository Institution]

[Street Address]

[City or Town, State, Zip Code]

By: _____
[Signature of Authorized Officer]

Print Name: _____

Title: _____

Date: _____

I hereby certify, after review of this letter, Appendix A of Operating Circular No. _____ of the Federal Reserve Bank of _____, and the pertinent regulations issued by the Department of the Treasury at Title 31, Code of Federal Regulations, Parts 202 and 203, that the _____ (name of the depository institution) is authorized to apply to be a Custodian and that _____ (name of authorized officer) has been authorized and directed to execute this letter.

IN WITNESS WHEREOF, I have signed my name (and affixed the seal of this depository institution).

By: _____
(Signature of Certifying Officer*)

(corporate seal, if any)

Print name _____

Title _____

Date _____

* The officer making this certification shall have the authority to do so and must not be the same officer signing the letter.

ACCEPTANCE

The Federal Reserve Bank of _____, [_____ Branch], acting as Fiscal Agent of the United States, and on behalf of each of the other Federal Reserve Banks, hereby designates _____ [name of depository institution] as third-party custodian and accepts the offer to contract made by the custodian, effective on the date set forth below, in accordance with the provisions of Appendix A to this Bank's Operating Circular No. , as revised from time to time.

Federal Reserve Bank of

[_____ Branch]
as Fiscal Agent of the United States

By: _____
[Signature of Official _____]

Print Name: _____

Title: _____

Date: _____

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APPENDIX NO. 2

**THIRD PARTY CUSTODY AGREEMENT
DEPOSITORY INSTITUTION'S OFFER TO CONTRACT AND
APPLICATION FOR DESIGNATION AS A THIRD PARTY CUSTODIAN
OF COLLATERAL PLEDGED UNDER
31 C.F.R., PARTS 202 AND 203**

To: Federal Reserve Bank of _____, _____ Branch,
Fiscal Agent of the United States. The undersigned depository institution,

(Full Name of Institution)

(as "Custodian"), hereby applies for designation to act as a Third Party Custodian for the Federal Reserve Bank addressed and for any other Federal Reserve Bank (any of which are hereinafter referred to as the "Reserve Bank"), in order to hold as an agent of the Reserve Bank, Fiscal Agent of the United States, securities pledged by any other depository institution (as "Pledgor") to secure deposits of public money under the provisions of Parts 202 and 203 of Title 31, Code of Federal Regulations.

To support its application, the Custodian represents that it is in the business of providing securities safekeeping services for other depository institutions and has done so for at least one year.

This application is for use only by Custodians that hold collateral in safekeeping on their premises. With the knowledge and prior approval of the Reserve Bank, and after executing specific agreements required by the Reserve Bank for such extended custody arrangements, Custodians may place securities in the custody of a depository which is an S.E.C.-registered clearing agency approved by the United States Department of Treasury for such purposes, for transfer to a Reserve Bank account which has been established to receive pledges of securities at such depository, subject to terms and conditions acceptable to the Reserve Bank.

If designated as qualified to be a Custodian by the Reserve Bank, and in consideration of the benefits and privileges related to such designation, the Custodian promises, warrants, and agrees:

1. To hold in its custody, as agent of the Reserve Bank, those eligible securities which a Pledgor may pledge as collateral to secure deposits of public money under the provisions of 31 C.F.R., Parts 202 and 203. (Federal Reserve book-entry eligible securities may not be held by a custodian.)
2. To hold the securities pledged subject exclusively to the Reserve Bank's written or properly authenticated wired instructions for release, delivery, substitution, withdrawal or other disposition. All instructions shall be executed without delay upon receipt of a written or properly authenticated wired order from the Reserve Bank to that effect. "Wired" transmissions as referred to in this document may be sent by cable, facsimile, telegraph, telephone, or other electronic transmission designated by the Reserve Bank.
3. To hold all collateral in safekeeping on the Custodian's premises;
4. To support every pledge of collateral by issuing to the Reserve Bank an advice of custody, in conformance with the following:
 - a. each advice of custody issued shall be delivered to the Reserve Bank in accordance with the Reserve Bank's delivery time schedules;
 - b. each advice of custody shall be issued only after the Custodian has confirmed that it possesses the securities; i.e., that the securities are (i) present on the Custodian's premises, or (ii) in the possession of a transfer agent for the purpose of re-registering them in the name of the Custodian's nominee.
 - c. each advice of custody issued shall include only securities which are negotiable or transferable. (For requirements regarding assignment of securities, see 31 C.F.R., Part 202.6 (d) or 203.15(e));
 - d. each advice of custody issued shall specify, without limitation, the following:

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- i. the name of the Pledgor;
 - ii. the name of the Custodian's nominee if any, in whose name the pledged securities are registered;
 - iii. a full description of the security, including the name of the issuer, CUSIP number, maturity date, and rate of interest;
 - iv. the original face value of the security, and the remaining balance for declining balance securities;
 - v. the name of the Reserve Bank pledgee;
 - vi. the purpose of the pledge; i.e., whether the collateral is being pledged to the Treasury under 31 C.F.R., Part 202 or Part 203. Separate advices of custody should be issued for collateral pledged under each Part.
5. That an advice of custody regularly issued with printed, facsimile, or other non-manual signature of an authorized officer or an electronic transmission of the Custodian shall have the same effect as if issued and manually signed by an authorized officer of the Custodian, provided the Reserve Bank receiving the advice has received prior written notice, and approved of the Custodian's procedures in this respect.
 6. That each advice of custody issued to the Reserve Bank shall be conclusive evidence of the facts stated in the advice.
 7. That any (a) interest payments by the obligor with respect to securities pledged under this custodial arrangement, and (b) proceeds of the redemption of maturing coupons shall be paid to the Pledgor, unless otherwise directed by the Reserve Bank.

Proceeds received with respect to principal payments on declining value securities shall be paid to the Pledgor unless the Reserve Bank directs otherwise. (Declining value securities are eligible only as collateral to secure public money under 31 C.F.R. 203).
 8. That the Custodian shall hold securities on its premises as agent for the Reserve Bank without compensation from the Reserve Bank, free and clear of all liens, charges or claims by the Custodian for safekeeping or otherwise, and shall mark its books to show that collateral is pledged to the Reserve Bank.
 9. With respect to securities pledged under this agreement, to indemnify and hold the Reserve Bank and the United States harmless from any loss that is proximately caused by the negligence or willful misconduct of the Custodian, or its employees, or agents, and that arises from the destruction, disappearance, theft, or unauthorized release of such securities.
 10. With respect to those securities pledged under this agreement that decline in value as payments of principal are made, to provide to the Reserve Bank, on not less than a quarterly basis, a statement of the original face value and the value of the remaining balance on each declining-value security pledged.
 11. To comply with terms and conditions specified by the Reserve Bank under instructions issued to prescribe the routine mechanics of pledging collateral, except that, in the event of any inconsistency between the terms of this document and the specified terms and conditions or the terms and conditions of the Custodian's advice of custody, the terms of this offer to contract and application shall prevail.
 12. To permit the Reserve Bank to inspect during the Custodian's regular business hours the Custodian's safekeeping premises, books and records of custodial accounts, and any securities pledged hereunder.
 13. To promptly respond in writing to the Reserve Bank's periodic requests for verification of the securities in its custody that are pledged to the Reserve Bank. Such requests will list the information required in an advice of custody (as set forth in paragraph 4d of this agreement) for all securities which the Reserve Bank's records reflect as being held by the Custodian and pledged to the Reserve Bank. The Custodian shall respond in writing by either confirming that it holds all such securities and that all information in the Reserve Bank's request is correct or by specifying any differences reflected in its records, whichever is appropriate.

Nothing in this agreement affects the Reserve Bank's supervisory or regulatory powers, or any other rights the Reserve Bank may have with respect to the Custodian. If the United States Department of the Treasury issues any amendment of this Agreement, notice will be provided to the Custodian by the Reserve Bank 60 calendar days in advance of the date such amendment becomes effective, provided the Treasury Department notifies the Reserve Bank to give such notice prior to that time, as the Treasury Department reserves the right to make amendments effective immediately (or in fewer than 60 calendar days) if such notice is impractical, unnecessary, or not in the public interest. Unless otherwise provided, any amendment will apply to all pledges of securities under this Agreement made on or after the effective date of the amendment.

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The Custodian may resign by giving 60 calendar days' prior written notice to both the Reserve Bank and the Pledgor. The resigning Custodian shall, on the effective date of its resignation, assign, transfer, and deliver to the Reserve Bank or the successor custodian designated to the Custodian by the Reserve Bank in writing, all funds, securities, or other assets held at that time by the resigning Custodian under this agreement without recourse, representation, or warranties of any kind, except as to acts or omissions of the resigning Custodian or claims against the resigning Custodian arising under this agreement prior to, or on the effective date of, the Custodian's resignation.

The acceptance of this Offer and the designation of the undersigned institution as Custodian may be revoked by any Reserve Bank with respect to that Reserve Bank, by providing the Custodian with advance written notice of such revocation. The revocation shall be effective ten calendar days after the date the notice is sent or transmitted. A copy of such notice shall simultaneously be transmitted to each of the other Reserve Banks. The notice of revocation may also contain instructions or orders to the Custodian concerning the assignment, transfer, and delivery to the Reserve Bank of all funds, securities, and other assets held by the Custodian under the terms of this Agreement. Revocation shall not affect the Reserve Bank's or the United States Department of Treasury's rights hereunder, with regard to any collateral pledged under the agreement prior to revocation.

This Offer to Contract and Application for designation as a Third Party Custodian of Collateral Pledged Under 31 C.F.R., Parts 202 and 203 supersedes any prior agreements for this purpose which may currently be in effect between the Custodian and the Reserve Bank. The undersigned depository institution agrees that upon acceptance by the Federal Reserve Bank of _____, acting as Fiscal Agent of the United States, this document shall evidence the contract entered into between the Secretary of the Treasury and the Custodian.

Signed on behalf of the applying depository institution by an officer duly authorized to execute this document as evidenced by the below executed certificate.

(Name of Depository Institution)

(Street Address)

(City or Town, State) (Zip Code)

By _____
(Signature & Title of Authorized Officer)

Date _____

Certified, after review of this form and pertinent regulations issued by the Department of Treasury at Title 31, Code of Federal Regulations, Parts 202 and 203, that the above applicant depository institution is authorized to apply to be a Custodian and that _____ (name) _____ has been authorized and directed to make this application.

IN WITNESS WHEREOF I have signed my name and affixed the seal of this depository institution.

By _____
(Signature of Certifying Officer*)

Date _____

(Name of Certifying Officer*)

(Name of Depository Institution)

* The officer certifying this resolution shall have such authority and shall not be the above referenced Authorized Officer.

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The Federal Reserve Bank of _____, [_____ Branch], acting as Fiscal Agent of the United States, and on behalf of each of the other Federal Reserve Banks, hereby designates (Name of Depository Institution) as Third Party Custodian and accepts the offer to contract made by the Custodian, effective on _____ (date) .

Federal Reserve Bank of _____

_____ as Fiscal Agent of the United States

By _____
(Name and Title of Official)